SUPPORTING ECONOMIC TRANSFORMATION

BRIEFING PAPER

Kick-starting economic transformation in Rwanda

Four policy lessons and their implications

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Key messages

- Rwanda should give priority to niche manufacturing that is employment-intensive and geared to global markets.
- This implies clustering closely related industries in special economic zones and supporting these preferentially with infrastructure and responsive organisation.
- As well as attracting foreign investors, the Government of Rwanda should use its demonstrated ability to mobilise domestic private enterprise to support export manufacturing.
- The Rwanda Development Board should be authorised and resourced to coordinate government action and support the 'discovery' processes of firms in selected value chains.

Introduction

Rwanda has committed itself to economic transformation as a pillar of the current seven-year government programme, the National Strategy for Transformation (NSTP1, 2017-24). Whether the country succeeds in this endeavour will depend in good part on whether it learns a small set of key policy lessons from international experience in economic transformation. This briefing sets out four such lessons, drawing on the most distinguished global thinking on the subject, as well as recent research on Rwanda by ODI's SET programme.

1. Specialising wisely

The international evidence is clear. As argued by Lin and Monga (2017), **under 21st century global conditions low-income countries *can* break through into economic transformation.** Countries like Rwanda *can* achieve goals such as creating 214,000 new jobs per year for the next seven years, the NSTP1 priority.

However, they will only do so if they choose their initial objectives wisely. They will fail if they do not. Initially, the aim should be **to put fully to work the economy's most abundant resource – unskilled labour – using technologies for doing so that are easily obtainable on the world market.** This should be done first in food-producing agriculture, and next or simultaneously in house construction and light manufacturing, so that rapidly increasing numbers of factory workers can be accommodated and fed (Studwell, 2013).

Few countries at Rwanda's level of per capita income have achieved sustained development without the twin supports of a productivity revolution in smallholder agriculture and major investments in employment-intensive manufacturing (Ansu et al., 2016a; ACET, 2017; McMillan et al., 2017). While agricultural policy has made notable progress in Rwanda over the last decade, alongside the expansion of modern services, **support for manufacturing is a comparatively recent priority, and there is much ground to be made up** (English et al., 2016; Ggombe and Newfarmer, 2017; World Bank, 2017a; Behuria and Goodfellow, 2018).

In Rwanda, as elsewhere, manufacturing will not expand fast enough if it fails to produce goods that can compete in expanding global markets. Regional markets such as D.R. Congo, for which Rwanda offers a locational advantage, should not be neglected. But they do not offer the same opportunities for manufacturing at constantly expanding scale using the country's most abundant resource, human labour.

To be competitive in global markets, Rwanda should emulate successful economies that until

recently had similar endowments of labour, capital and land. According to Lin and Monga (2017), that means emulating the industries of countries now at approximately twice Rwanda's per capita income (e.g. Bangladesh, Cambodia).

Given its comparatively high transport and energy costs, **Rwanda should be seeking to export products to the global market that combine low energy intensity, high labour intensity and high value per unit of output** (Hausmann and Chauvin, 2015). The different but complementary models established by C&H Garments and the local cooperative in Masoro linked to the international handbag brand Kate Spade show the way. C&H Garments is specialising in the least time-sensitive types of clothing, while the brand-name price margin of the Kate Spade operation helps to cover high air transport rates.

Inspired by these examples, **Rwanda should be aiming to establish a suitable niche in world market production corresponding to what Lin and Monga call its 'latent' comparative advantages.**

Typical mistakes that have often been made by countries at Rwanda's stage of development include:

- using scarce capital to support inefficient investments to save foreign exchange, rather than more efficient investments to earn foreign exchange
- defying the principle of latent comparative advantage by emulating far richer economies, where labour/capital/land ratios are quite different.

In order to avoid these errors, the Government of Rwanda (GoR) should build up its capacity to apply two simple tools:

- the long-established Domestic Resource Cost (DRC) method for appraising alternative investment options (Calabrese, 2017)
- the Lin/Monga Growth Identification and Facilitation Framework (GIFF) (Lin, 2012).

In assessing priorities, the GoR should also take account of the institutional (especially coordination) challenges that need to be overcome before an identified potential can be realised. This applies particularly to horticulture and agro-processing projects that depend on backward linkages to smallholder-based supply chains, which are notoriously hard to transform quickly. The relative tractability of the supply-chain issues in light manufacturing sectors such as exportable garments is an additional reason for prioritising those sectors.

2. Clustering and concentrating

Experience in Asia and elsewhere shows that the key to manufacturing success is not only specialising wisely, but **building clusters of new industries and providing concentrated support** (Oqubay, 2015; Newman et al., 2016). Well-designed industrial parks or special economic zones (SEZs) can:

- allow scarce infrastructure and organisational capabilities to be provided selectively to the economic activities with the best economic transformation potential
- capture the learning externalities associated with geographical locations where firms engaging in similar activities cluster together.

Lin and Monga (2017) highlight two corresponding errors. One is to spread the country's scarce resources too thinly across a large range of high priority and moderate priority sectors, with a view to balance or inclusiveness. In fact, a strategy of concentration is more likely to produce fast progress for the largest number of people. Therefore, a major objective of government policy should be providing the infrastructure, logistics support, market access, training and coordination that the prioritised industries require.

The second error – responsible for many of the failures of SEZs across the world – is to allow industrial zones to be occupied randomly or to meet secondary policy objectives, so that the learning benefits of clustering are diluted or lost.

By these standards, support to export manufacturing and SEZs in Rwanda needs a) stronger prioritisation in relation to other policy concerns and a greater sense of urgency, and b) deliberate efforts to ensure that future SEZs and industrial parks are genuine manufacturing clusters.

3. Coordinating foreign and domestic capabilities

In today's world economy, countries can enter segments of global value chains only with the help of foreign clients and investors. **But in the most successful export-oriented clusters, foreign-owned 'anchor firms' are surrounded by domestic operations that are able to emulate their production processes and their modes of insertion into international value chains.**

After establishing an export niche, it is important that key production and business capabilities pass quite quickly to nationals of the country. Indigenous firms must begin to acquire their own technological and business capabilities so that the country does not get locked into a low-wage role and a 'race to the bottom' as poorer countries enter the competition (Kaplinsky, 2005; Gereffi, 2014; Kaplinsky, 2016).

This is one of the factors explaining why success in Asia has been quite uneven. At one extreme, South Korea followed firmly in the path of Japan, acquiring foreign technology without much reliance on foreign direct investment (FDI), eventually creating world-beating firms at the leading edge of technological development. In contrast, Malaysia and Thailand have disappointed expectations. They relied too much on FDI in building export-oriented assembly operations, doing too little to push domestic firms into the same or linked activities. As a result, they have had difficulty moving to the next stage where domestic firms lead a process of continuous technological upgrading (Studwell, 2013; Pritchett et al., 2017)**.**

The experience of the past twenty years has shown that Rwanda has a local private sector that is highly responsive to steering by government. Even though government steering has contributed to some overshooting in the real-estate, construction and hospitality sectors (World Bank, 2017b), the most important lesson to be drawn is that government and the local private sector together have the means of mobilising large amounts of capital and enterprise around shared goals.

An urgent task for Rwanda in the next phase of its development is to harness this potential to support a breakthrough into export manufacturing. Interview-based research on the local business community (Golooba-Mutebi and Booth, 2018) has confirmed that a far-from-insignificant number of Rwandan entrepreneurs have the financial resources to venture into manufacturing, by either establishing a factory or helping supply industrial park infrastructure, if they choose to do so.

For many of our interviewees, manufacturing is something entirely new, about which they know little and the returns from which seem uncertain. Some interviewees were also concerned about market size and the ability of Rwandan producers to compete with firms from Kenya, Tanzania and Uganda. As this illustrates, however, **manufacturing prospects are widely understood as being essentially about import substitution, which we argue is not the area of greatest potential.**

In leading the local private sector forward, GoR should make clear its top priority is export manufacturing. It can make further use of instruments that have already proven their ability to convince local entrepreneurs to overcome their reticence about new ventures. This might well include foreign visits that bring home what countries like Ethiopia are achieving by becoming niche suppliers to expanding global markets.

As well as giving clearer policy signals, the government should be opening access to more affordable financing for manufacturing projects (Calabrese et al., 2017). It should also be actively identifying and cultivating potential partnerships between local investors and suitable anchor firms in promising international value chains. **A leading role in this effort obviously falls to the Rwanda Development Board (RDB).**

4. Organising for steering and learning

Successful transformers in Asia have had a public agency or agencies with the power and resources to steer the process, enforcing priorities and ensuring consistency in implementation (Ansu et al., 2016b). Rwanda should not ignore this important aspect of the Asian experience.

As research has emphasised (Akileswaran et al., 2017; Booth et al., 2017) **this role is hard to perform well.** It demands more than the level of coordination provided by the types of inter-ministerial task forces or consultative committees that normally feature in government systems in Africa. It needs to include a strong element of learning from experience and making timely policy adjustments. It also calls for an ability to relate to the needs and concerns of private businesses and the dynamics of global value chains that is uncommon among government officials in developing countries.

The coordinating agency needs to be equipped to select wisely both foreign and domestic firms that have potential to lead new manufacturing clusters. It should be able to manage the limited and conditional subsidies that modern industrial policies require, which means having both intimate knowledge about, and a degree of distance from, private business interests – the 'embedded autonomy' made famous by Evans' (1995) book. **This combination of encouragement and discipline has been hard to achieve and sustain, even in the best of cases** (Altenburg and Lütkenhorst, 2015).

RDB has not until now had the mandate and resources to undertake such a role effectively. Although based on an Asian model (Singapore's Economic Development Board), it is restricted in practice by its status as executive agency, providing multiple services and implementing policies designed and monitored by ministries (Behuria, forthcoming-a).

Asian experience and modern industrial policy thinking also emphasises that success in transformation comes from a 'discovery' process, undertaken by firms but requiring governmental support and understanding. **In the past, joint learning with firms in particular sub-sectors has been patchy in Rwanda** (Behuria, forthcoming-b).

In his speech opening the African Transformation Forum in Kigali in 2016, President Kagame emphasised that development processes involve a substantial element of learning by trial and error. It is also true that some of Rwanda's most celebrated policy successes are the product of what Andrews et al. (2013) call problem-driven iterative adaptation (PDIA).

In contrast, a common observation is that **trial-and-error thinking is not a common feature of the day-to-day practice of government in Rwanda.** Reasons include the youth and inexperience of many officials, the rigour with which 'administrative errors' are handled and the rigidity of some *imihigo* (performance contract) monitoring.

What has been achieved in Rwanda with corruption control and *imihigo* is important, and we would not propose the adoption of new systems across the whole civil service. However, **the priority task of kick-starting economic transformation cannot be tackled without some purposeful experimentation to identify opportunities and avoid potential pitfalls.**

It is important in this context that no successful Asian economy modernised its civil service comprehensively during the early stages of industrialisation. **The key learning took place in a limited set of public agencies charged with the main responsibility of interacting with the private sector to achieve economic transformation.** These public agencies were given both the resources to deliver against their mandates and special authority to be experimental in their approach.

This should guide the way RDB is staffed, managed and assisted. The core team leading the work on economic transformation should have authority to coordinate, should be well-supported with private-sector and value-chain expertise, and should be incentivised to experiment and learn.

Conclusions and implications

In summary:

- **Wise specialisation, in the Rwanda context, means giving clear priority to niche manufacturing that is employment-intensive and geared to global markets.**
- This implies clustering closely related industries in SEZs and supporting them preferentially with infrastructure – buildings, roads, power and water – and high-grade, responsive organisation.
- **As well as attracting foreign investors linked to global value chains, GoR should use its demonstrated ability to mobilise domestic private capital to encourage local entrepreneurs to support export manufacturing.**
- RDB should be authorised and resourced to follow the best Asian models in learning how to coordinate government action well and support the 'discovery' processes of firms in selected value chains.

These conclusions point to four practical questions for the GoR and organisations wanting to support NSTP1:

- How can employment-intensive manufacturing for global markets get greater effective priority in line with the NSTP goals?
- **What can be done to accelerate and ensure effective coordination of the roll-out of the SEZ/industrial parks programme?**
- How can the local private sector be mobilised to support export manufacturing and SEZ infrastructure?
- **What can be done to boost RDB's ability to coordinate, by providing it with the needed authority, international market expertise, and foresight and learning capacity?**

These issues should be the subject of urgent discussion.

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